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IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

PROMETHEUS FUNDING CORP., ETC., *et al.*,
Petitioners,
v.
MERCHANT HOME DELIVERY SERVICES, INC.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF AMICI CURIAE, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, AMERICAN INSURANCE ASSOCIATION, ALLIANCE OF AMERICAN INSURERS, AND AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONERS

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This brief is submitted by the National Association of Independent Insurers, the American Insurance Association, the Alliance of American Insurers and the American Council of Life Insurance (hereinafter "Amici") in support of the Petition for Writ of Certiorari filed by Prometheus Funding Corporation, et al ("Petitioners") seeking review of the decision of the Court of Appeal for the

Ninth Circuit in *Merchant Home Delivery Service, Inc. v. Frank B. Hall & Co. et al*, 50 F.3d 1486 (9th Cir. 1995) ("*Merchant Home Delivery*"). Amici urge the Court to grant the petition.[1]

STATEMENT OF INTEREST OF AMICI

The National Association of Independent Insurers ("NAII") is a volunteer, nonprofit insurance trade association. Its 570 member companies primarily write property and casualty insurance in the United States. The American Insurance Association ("AIA") is a volunteer, non-profit insurance trade association with approximately 270 member property-casualty insurers country-wide. The Alliance of American Insurers ("AAI") is a volunteer, non-profit insurance trade association representing more than 220 property-casualty insurance companies nationwide. The American Council of Life Insurance ("ACLI") is a volunteer, non-profit insurance trade association with more than 600 member life and health insurance companies country-wide. All four Amici regularly appear, on behalf of their members, before Congress and state legislatures, regulatory agencies and courts.

Amici collectively represent a broad spectrum of the insurance industry in the United States. Their members include both large insurers serving national markets and small specialty and regional insurers. The Amici also represents both the property-casualty and the life-health branches of the insurance industry. Amici, therefore, bring a different perspective to this case than the other parties. Amici are concerned about the implications of the Ninth Circuit's ruling for their members' operations throughout this country and the probability that the Ninth Circuit's decision will generate a significant increase in

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[1] All parties have consented to the filing of amicus curiae briefs in connection with the Petition for Writ of Certiorari in this matter and letters documenting that consent have been filed with the Court.

claim defense and settlement costs as routine claim and coverage disputes become Racketeer Influenced and Corrupt Organizations Act ("RICO") cases.

SUMMARY OF ARGUMENT

Amici submit that this case was wrongly decided as a matter of law. The Ninth Circuit's decision in *Merchant Home Delivery* will disrupt insurer operations in California and other states by substantially narrowing the scope of the McCarran-Ferguson Act, which gives the states plenary authority over the business of insurance. The decision is also a major step toward the "federalization" of insurance regulation, since the Ninth Circuit reached a diametrically opposite conclusion from the California appellate court which had previously held that allowing RICO remedies would impair California's insurance regulatory scheme. Given the conflict among the federal courts and between federal and state courts concerning the availability of RICO remedies in litigation involving insurance claims, *Merchant Home Delivery* will exacerbate the problem of inconsistent results across jurisdictions already faced by insurers. If not reversed, the *Merchant Home Delivery* decision is likely to significantly increase insurers' defense costs in what previously were routine cases and, therefore, the cost of insurance to their policyholders.

ARGUMENT

I. WHETHER RICO REMEDIES ARE AVAILABLE IN ROUTINE INSURANCE DISPUTES IS OF MAJOR IMPORTANCE TO INSURERS AND THEIR POLICYHOLDERS WHO WILL FACE HIGHER COSTS IN THE WAKE OF *MERCHANT HOME DELIVERY*.

A. The *Merchant Home Delivery* Decision Fundamentally Undercuts Congress' Determination That Insurance Should Be Regulated By The States.

In holding that the application of RICO to the Petitioners' actions would not "invanidate, impair, or supersede" California law, the Court below has significantly intruded into state regulation of insurance. *Merchant Home Delivery v. Hall & Co., supra*, 50 F.3d at 1492. This intrusion is contrary both to the letter and the spirit of the McCarran-Ferguson Act, 15 U.S.C.A. 1011 *et seq.* The McCarran-Ferguson Act was enacted by Congress to preserve the traditional authority of the states to regulate insurance following this Court's 1944 decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944). *South-Eastern Underwriters* held that insurance was in interstate commerce and, therefore, subject to federal law under the Commerce Clause. In order to maintain state regulatory authority over insurance, Congress passed the McCarran-Ferguson Act, which provides in pertinent part: "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." *See Group Life and Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205, 218-219 (1979) (purpose of McCarran-Ferguson is to preserve state regulation of insurance as it existed before *South-Eastern Underwriters*).

In this case, the Ninth Circuit ruled that application of RICO to overcharges for insurance coverage did not "in-

validate, supersede or impair" California's insurance regulatory laws. California has enacted a comprehensive scheme regulating premiums charged for property-casualty insurance, the type of coverage at issue in this case. Rates are required to be filed with and approved by the Department of Insurance. Cal. Ins. Code § 1861.01. The charging of a rate other than the rate approved by the Commissioner of Insurance is prohibited under Section 1858.07 of the California Insurance Code which provides:

> Any person who uses any rate, rating plan, or rating system in violation of this chapter is liable to the state for a civil penalty not to exceed five thousand dollars ($5,000) for each act, or if the act or practice was willful, a civil penalty not to exceed ten thousand dollars ($10,000) for each act.

Enforcement of Section 1858.07 is exclusively within in the authority of the Commisioner of Insurance. Subpart (b) of that section provides: "The penalty imposed by this section shall be imposed by and determined by the commissioner . . . ." The charging of unauthorized premiums is also prohibited by California's Insurance Unfair Practices Act which prohibits unfair methods of competition and unfair or deceptive acts and practices in the business of insurance.[2] Cal. Ins. Code § 790 *et seq.* The Insurance Unfair Practices Act itself states that it is intended to preempt federal law as permitted by the McCarran-Ferguson Act. Section 790 of the California Insurance Code provides:

> The purpose of this article is to regulate trade practices in the business of insurance in accordance with the intent of Congress as expresed in [the McCarran-Ferguson Act], by defining, or providing for the determination of, all such practices in this State, which constitute unfair methods of competition or

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[2] The Insurance Unfair Practices Act is applicable to insurance brokers such as Petitioners. Cal. Ins. Code § 790.01.

unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

Not only is there a comprehensive state regulatory scheme prohibiting the charging of excessive premiums, but those statutes have been construed by the California courts to preclude private causes of action under insurance and consumer protection statutes. In *Moradi-Shalal v. Fireman's Fund Insurance Co.*, 46 Cal.3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988), the California Supreme Court held that there was no private right of action under the Insurance Unfair Practices Act. Recently, the California Supreme Court stated that the Insurance Unfair Practices Act was enacted "to displace feedral law." *Manufacturers Life Insurance Company v. Weil Insurance Agency, Inc.*, 10 Cal.4th 257, 266, 275, 895 P.2d 56, 41 Cal.Rptr.2d 220 (1995). Thus, not only has the California legislature exhaustively regulated the practices at issue in this case, the California courts have repeatedly ruled that the insurance regulatory scheme created by the California legislature is intended to supersede any federal law that might otherwise have been applicable. A half century ago, Congress in enacting the McCarron-Ferguson Act granted state legislatures this power. Although Congress has never modified its stance, the Ninth Circuit now has significantly amended the McCarron-Ferguson Act by allowing federal remedies never contemplated in the California insurance regulatory statutes.

Amici believe that the Ninth Circuit erred in concluding that the availability of a civil RICO action will not impair California's comprehensive regulatory scheme which grants exclusive enforcement authority to the Commisioner of Insurance. The Ninth Circuit, in holding that McCarran-Ferguson's "impairment" language is not triggered by federal statutes which provide remedies significantly broader than those available under state insurance laws, in practical terms may have gutted the McCarran-Ferguson Act. Under the Ninth Circuit's in-

terpretation, only in the very rare instance when a federal statute of general application prohibits conduct allowed under state insurance law, or visa versa, will McCarran-Ferguson preemption apply.

The Ninth Circuit relied on the Seventh Circuit's decision in *NAACP v. American Family Mutual Insurance Co.*, 978 F.2d 287 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 2335 (U.S. 1993), in reaching its decision in *Merchant Home Delivery*. Amici question whether *American Family Mutual* was correctly decided, since its conclusion that federal law is only preempted where there is a direct conflict between the substantive state and federal provisions is difficult to reconcile with other decisions construing the impairment language of the McCarran-Ferguson Act. *See, e.g., F.T.C. v. National Casualty Co.*, 357 U.S. 560 (1958) (federal false advertising statute preempted by state insurance false advertising statute based on the same model as California's Insurance Unfair Practices Act); *Gordon v. Ford Motor Credit Co.*, 868 F. Supp. 1191 (N.D. Cal. 1992) ("application of RICO would impair, invalidate and supersede the body of substantive laws which California has enacted to govern insurance practices"); *Wexco, Inc. v. IMC, Inc.*, 820 F. Supp. 194 (M.D. Pa. 1993) (McCarran-Ferguson preemption where insurance broker accepted premium but failed to secure insurance—the precise conduct alleged in *Merchant Home Delivery*). Nevertheless, the *Merchant Home Delivery* goes well beyond the decision in *American Family Mutual*. In *American Family Mutual*, the Seventh Circuit noted: "No official of Wisconsin has appeared in this litigation to say that a federal remedy under the Fair Housing Act would frustrate any state policy." *NAACP v. American Family Mutual, supra*, 978 F.2d at 297. In profound contrast, the California courts have explicitly stated that state insurance laws would be subverted and subsumed by the availability of a private RICO action for conduct in violation of insurance regulatory laws.

The Ninth Circuit's holding in *Merchant Home Delivery* is flatly contrary to a California appellate decision *explicitly* stating that the state's insurance regulatory policy would be subverted and subsumed by the availability of a private RICO action for conduct governed by the Insurance Unfair Practice Act and other provisions of the California Insurance Code granting exclusive enforcement authority to the Insurance Commissioner. *American International Group, Inc. v. Superior Court*, 234 Cal. App.3d 749, 285 Cal. Rptr. 765 (1991), *cert. denied sub nom. Brutoco Engineering & Construction, Inc. v. American International Group, Inc.*, 504 U.S. 911 (1992). In reaching this conclusion, the California Court of Appeal stated:

> Allowance of a RICO action seeking civil damages (including treble damages and attorney's fees) for the very conduct which California has chosen to regulate administratively would subvert and subsume the existing statutory scheme. It would permit a civil damage recovery where our Supreme Court has recently and explicitly held that none was intended. (*Moradi-Shalal, citation omitted.*) This would not be the first time creative litigation efforts had been unsuccesfully expended to get around that decision.

American International Group, Inc. v. Superior Court, supra, 234 Cal.App.3d at 768, 285 Cal. Rptr. at 777.

Remedies are not an inconsequential detail of California's system of regulating insurance practices. California's policy of limiting the remedies available to private parties for actions in violation of statutes regulating the conduct of insurers has been articulated in a series of recent decisions by the California courts. This history begins with *Royal Globe Insurance Co. v. Superior Court*, 23 Cal.3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979), in which the California Supreme Court held that a private plaintiff could bring an action for insurer practices in violation of the Insurance Unfair Practices Act (Cal. Ins. Code § 790 *et seq.*). Almost ten years later,

in *Moradi-Shalal, supra*, 758 P.2d 58, 46 Cal.3d 287, 250 Cal.Rptr. 116, the Supreme Court concluded *Royal Globe* had been incorrectly decided and eliminated private rights of action under the Insurance Unfair Practices Act.[3]

Amici are not jumping at shadows in believing that the *Merchant Home Delivery* decision carves a large hole in Congress' mandate that insurance be regulated by the states, rather than subject to federal statutes of general application. Since in *Merchant Home Delivery* there was a prior determination by a state court that the RICO remedies were incompatible with California's insurance regulatory statutes, it is unlikely that a federal statutory remedy can ever be found to "invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance" under the Ninth Circuit's interpretation of the McCarran-Ferguson Act.

Where a state has declared its policy of limiting the remedies available for violations of its insurance regulatory statutes as unequivocally as California has here, there is a direct and significant conflict between the state policy and a federal statute which allows not only a private right of action, but also treble damages and attorney's fees. Amici respectfully submit that the Ninth Circuit erred in concluding that there was no conflict between federal and state law is this case.

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[3] A subsequent series of decisions has held that the Insurance Unfair Practices Act preempts other state statutes under which a private right of action is available, if the alleged insurer misconduct is within the scope of the Insurance Unfair Practices Act. The California courts have been resistant to attempts to end-run the limitations on private actions imposed in *Moradi-Shalal*. *See, e.g., Maler v. Superior Court*, 220 Cal. App.3d 1592, 270 Cal. Rptr. 222 (1990); *Safeco Insurance Co. v. Superior Court*, 216 Cal. App.3d 1491, 265 Cal. Rptr. 585 (1990); *Industrial Indemnity Co. v. Superior Court*, 209 Cal. App.3d 1592, 257 Cal. Rptr. 1093 (1989).

B. The *Merchant Home Delivery* Decision Does Not Serve the Best Interests of Policyholders.

Amici firmly believe that fraudulent, unfair or deceptive acts against policyholders should not be tolerated. However, it does not follow that policyholders' welfare increases whenever an additional remedy is made available. The costs of defending policyholders against lawsuits brought by other parties and the cost of disputes concerning the extent of coverage under insurance policies are reflected in insurance premiums. *Merchant Home Delivery* opens the door to the practice of filing garden variety bad faith insurance claim settlement and insurance coverage disputes as RICO actions. The availability of treble damages and attorneys' fees is likely to make this opinion attractive to a large number of litigants.

There can be no doubt that insurance premiums will increase as cases are settled at higher figures because of the threat of RICO remedies. Insurers' ability to resist excessive or fraudulent claims will be undercut by the availability of private RICO actions with the potential for treble damages and attorneys' fees. Insurers are likely to settle inflated or dubious claims which formerly would have been contested more virogously. Policyholders will pay the price in higher premiums.

The use of RICO as the vehicle of choice for routine insurance litigation has several additional consequences. First, federal rather than state courts will increasingly be deciding insurance bad faith claim settlement and coverage cases. Not only will this impose an increased burden on the federal court system, it also is likely to result in unpredictable and inconsistent decisions. As happened in *Merchant Home Delivery*, a federal court may well reach a different conclusion than the state court on the availability of federal remedies. Moreover, the federal courts are divided on the application of RICO in insurance liti-

gation.[4] As a consequence, Amici's member companies who do business country-wide will face a different gamut of remedies in different jurisdictions, or between federal and state courts in the same jurisdiction. This unpredictability, in and of itself, will increase costs to Amici's member companies; cost which ultimately are passed along to policyholders.

Second, if the Ninth Circuit's decision in *Merchant Home Delivery* is allowed to stand, many aspects of insurance regulation which are peculiarly within the expertise of the various state insurance commissioners will be addressed in private litigation. Courts in contexts other than McCarran-Ferguson have wisely avoided intruding into matters subject to the approval of regulatory agencies. *See, e.g., Wegoland, Ltd. v. Nynex Corp.*, 27 F.3d 17, 21 (2d Cir. N.Y. 1994) (in a RICO action "that the remedy sought can be characterized as damages for fraud does not negate that fact that the court would be determining the reasonableness of rates"). For example, insurance commissioners routinely conduct "market conduct" examinations of insurers. Such examinations cover a wide range of marketing, underwriting and claims settlement practices. A market conduct examination culminates in a formal report setting forth areas in which the insurer's practices do not conform to the requirements of the state's statutes or regulations. Depending on the magnitude of the discrepancies uncovered in the examination, the insurance commissioner may merely instruct the insurer to take corrective action, or it may seek a consent decree with a substantial civil penalty.

Under *Merchant Home Delivery*, a policyholder or agent aggrieved by a practice criticized in a market conduct examination will have a ready-made cause of action under RICO. Disputes between insurers and insurance

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[4] See cases at footnote 4 in the Petition for Writ of Certiorari.

regulators concerning the content of market conduct examination reports and the recommended remedies will become common. Consent decrees will be entered into less frequently because insurers will no longer view entry of a consent decree and the payment of a penalty as closing an examination, but as opening the door to further litigation. As a consequence, the insurance regulator's enforcement resources will be stretched thin as the federal courts become the principal forum for regulating the conduct of insurance companies and their agents and employees.

Amici submit that the Ninth Circuit's conclusion that allowing a private RICO action for the overcharging of premiums on insurance policy would not impair a state regulatory scheme was incorrect. The California courts have explicitly stated that allowing private statutory remedies for activities governed by the Insurance Unfair Practices Act and other Insurance Code provisions would disrupt California's regulatory regime. Since the *Merchant Home Delivery* decision does not in any manner limit the varieties of alleged insurer misconduct which are now to be made subject to RICO, the incentives of treble damages and attorney's fees will increase the number of private claims filed against insurers and increase the cost of resolving those actions. The cost of this upsurge in litigation will be borne by insurers and their policyholders. Amici submit that the costs of adding RICO damages to state law remedies significantly outweigh any benefits to policyholders or the public.

II. THE NARROW DEFINITION OF "BUSINESS OF INSURANCE" ADOPTED BY THE NINTH CIRCUIT UNDULY LIMITS McCARRAN-FERGUSON.

The Ninth Circuit adopted an exceptionally narrow definition of "business of insurance" in the *Merchant Home Delivery* decision. This definition cannot be reconciled with the decisions of this Court regarding the scope

of the "business of insurance." The Court has enunciated a three part test for determining whether a practice falls within the "business of insurance": 1) whether the practice involves risk-spreading, 2) whether the practice is an integral part of the relationship between an insurer and an insured, and 3) whether the practice is limited to entities within the insurance industry. *United Labor Life Insurance Co. v. Pireno,* 458 U.S. 119, 129 (1982).

The Court has recently held that this test should be construed narrowly where an exemption from the antitrust laws is claimed and broadly in all other instances. *U.S. Department of the Treasury v. Fabe,* 113 S. Ct. 2202 (1993). In *Fabe,* the Supreme Court found that the Ohio insurer insolvency priority statute preempted federal law under McCarran-Ferguson. In so holding, the Supreme Court distinguished cases involving the narrow insurer exemption from antitrust liability and stated that the first clause of section 2(b) of the McCarran-Ferguson Act, 15 U.S.C.A. § 1012(b), "is not so narrowly circumscribed" as the second clause setting forth the antitrust exemption.[5] *Id.* at 2209. In *Fabe,* the Supreme Court stated that the first clause of section 2(b)—the portion of the McCarran-Ferguson Act at issue in this case—"was intended to further Congress' primary objective of granting the states *broad* regulatory authority over the business of insurance." *Id.* at 2210 (emphasis added).

The distinction drawn in *Fabe* between the narrow McCarran-Ferguson exemption from antitrust laws and the broad exemption from all other federal statutes cannot be reconciled with the Ninth Circuit's analysis of the

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[5] The first clause of section 2(b), which contains the "invalidate, impair or supersede" language is set forth above. The second clause provides: "After June 30, 1948, . . . the Sherman Act, . . . the Clayton Act, and the . . . Federal Trade Commission Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by the states.

"business of insurance." In holding that the failure of an insurance entity to deliver an insurance product while accepting premium is not within the "business of insurance," the Ninth Circuit applied an unduly narrow interpretation of this Court's three part test. Amici respectfully submit that the decision misconstrues the first (risk transfer) and second (insurer-insured relationship) parts of the test, while substantially ignoring the third (the practice is limited to the insurance industry) component. The Ninth Circuit concluded that because no insurance coverage was provided, there was no risk transfer and no insurer-insured relationship. *Merchant Home Delivery v. Hall & Co., supra*, 50 F.3d at 1490-1491. This analysis ignores the plain fact that the plaintiff in this case was attempting to transfer risk and intended to enter into an "insurer-insured" relationship.

The *Merchant Home Delivery* decision treats the individual insurance contracts which were not delivered as not being part of the "business of insurance," notwithstanding the stream of insurance policies purchased by Respondent through Petitioner insurance brokers. Only by disaggregating the insurer-insured relationship did the Ninth Circuit conclude that the failure to provide requested insurance coverage is not within the "business of insurance." This microscopic view of an ongoing relationship implies that many other transactions previously considered to be the "business of insurance" may not be subject to McCarran-Ferguson preemption. In particular, the *Merchant Home Delivery* decision cannot be reconciled with the recent Eleventh Circuit decision in *Barnett Bank of Marion County, N.A. v. Gallagher*, 43 F.3d 631 (11th Cir. 1995) *cert. granted*, No. 94-1837 (U.S. Sept. 27, 1995) which held that the McCarran-Ferguson exemption applies to *potential* as well as actual policyholders.[6] *Barnett* is consistent with this Court's decision in *F.T.C.*

[6] The Respondent indisputably was a potential policyholder with respect to the insurance coverage which allegedly was not provided.

v. National Casualty Co., 357 U.S. 560, 78 S. Ct. 1260 (1958). That decision held that the Federal Trade Commission had no authority to regulate advertising by insurers because such advertising was regulated by state insurance laws which, pursuant to the McCarran-Ferguson Act, preempted the federal statute. Advertising is directed to potential policyholders, and does not—in the microscopic view adopted in *Merchant Home Delivery*—involve either risk transfer or an existing insurer-insured relationship. Thus, the *Merchant Home Delivery* decision simply cannot be reconciled with this Court's established test for determining activities which constitute the "business of insurance."

Under the Ninth Circuit's *Merchant Home Delivery* analysis, every failure to provide insurance coverage could trigger a RICO claim on the theory that if no coverage was provided, no risk transfer took place. There are numerous disputes each year between policyholders and insurers concerning whether coverage for particular losses exists and whether the insurer (or its agent) misrepresented that such losses would be covered. Such disputes will be readily characterized as the provision of "sham insurance policies." *Merchant Home Delivery v. Hall & Co., supra,* 50 F.3d at 1491. If not overturned, the *Merchant Home Delivery* decision will permit policyholders and third party claimants to introduce a host of federal statutory allegations into coverage and sales misrepresentation cases. There can be little doubt that McCarran-Ferguson preemption will be eroded and that the number of suits involving insurance claims filed in federal courts is likely to explode.

CONCLUSION

For the reasons stated herein, Amici respectfully request that the Petition for Writ of Certiorari be granted.

Respectfully submitted,

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